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SIPDIS

SENSITIVE

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TAGS: EAIR ECON RS AM

SUBJECT: ARMENIA'S MAIN AIR CARRIER SCOTCHES PLANS

FOR EUROPEAN ORIENTATION

¶11. (U) This cable is sensitive but unclassified. Please protect accordingly.

SUMMARY

¶12. (SBU) Completely reversing its previous investment policy, Armenia's main flag carrier, Armavia Airlines, is halting its plans to expand towards Europe and move to European standards and is replacing its modern aircraft with older Soviet models in an effort to reduce costs. The move is a breach of Armavia's agreement with the Government of Armenia and is a vote of no confidence in the commercial viability of a modern airline servicing European routes from Yerevan. END SUMMARY.

ARMAVIA AIRLINES REVERSES INVESTMENT STRATEGY

¶13. (SBU) Bob Chaplin, a British consultant who has been managing Armavia, told us that Armavia's directors have decided that the investments necessary to expand Armavia's service to European cities were not justified. Specifically, he said that they were unwilling to accept losses in the initial years of investment and preferred to pocket the earnings from cheap but profitable point-to-point flights in the CIS. According to Chaplin, for the moment Armavia will continue to operate its current European flights to Frankfurt and Amsterdam in order to avoid forfeiting its exclusive licenses to the routes, for which the company paid USD 14.5 million. Chaplin noted that these routes will remain profitable through summer, but after that he expects that Armavia will probably try to sell the licenses or liquidate during next winter.

GETTING OUT OF EUROPE

¶14. (SBU) The sudden reorganization of Armavia's assets signals a clear exit strategy from the European routes. Armavia will transfer three of its five Airbus 320s to Siberian Airlines in Russia and replace them with old Soviet planes that are not allowed to land in European Airports. (Note: Siberian Air owns a controlling share of Armavia Airlines. End Note.) The airline has also halted negotiations with Lufthansa on interline connections through Frankfurt and have withdrawn their bid for International Air Transport Association (IATA) certification.

"TOO RUSSIAN"

¶15. (SBU) "The directors are too Russian," Chaplin told us when asked why Armavia had failed in its plan to become a western airline. The expense of meeting European standards had proven to be far more than the directors anticipated or were willing to bear. He highlighted as examples the fact that the directors refused to fly scheduled flights when they were not full, refused to contract an attorney to negotiate interline agreements, and refused to open their aircraft and their books to inspection by third parties.

CHANGES A BREACH OF CONTRACT

¶16. (SBU) Armavia's withdrawal from its strategy puts it in breach of several investment conditions of its contract with the GOAM: it is not yet clear how the government will react, however. In case of a material breach the government has the right to cancel Armavia's licenses and resell them to another airline. According to Viktor Mnatsakanian, the legal advisor to Minister of Justice David Harutunyan, the Minister is aware of Armavia's move but the government has not yet taken any decision on how to respond.

COMMENT

17. (SBU) If the GOAM were to revoke Armavia's licenses it could exacerbate the situation considerably: Armavia's USD 14 million loss would likely send danger signs to potential investors. The reversal of Armavia's strategy is a serious blow to Armenia's civil aviation industry, suggesting that Armenia cannot support an airline that meets modern Western standards and depriving a land-locked country of vital transportation links.

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